



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Number: **201130006**  
Release Date: 7/29/2011

Date: May 5, 2011

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

UIL: 507.00-00; 4940-00-00; 4941-00-00; 4942.00-00;  
4945.00-00

Legend:

A =  
B =  
C =  
M =

Dear :

This is in response to your ruling request regarding the proper treatment of a transfer of part of your assets to another private foundation under sections 507, 509, 4940, 4941, 4942, 4945, and 4946 of the Internal Revenue Code ("Code").

Facts:

You are a trust that is recognized as an organization described in section 501(c)(3) of the Code and classified as a private foundation under section 509(a). A, who is a trustee, along with his daughters, B and C, established you. Since your inception, A's involvement in your management has diminished. In addition, B and C's charitable interests have diverged. It has thus become difficult for you to develop a unified approach to grant making. Accordingly, A established M to carry out C's separate charitable objectives. M is an organization described in section 501(c)(3) of the Code and classified as a private foundation under section 509(a). You propose to transfer 50 percent of the fair market value of your total assets to M. The assets transferred would be a combination of cash and securities and you would receive no consideration for the transfer.

You will make your transfer to M pursuant to a Pre-Grant Inquiry Report and an Endowment Grant Agreement, which provide that the grant is intended to be an "endowment fund" for purposes of state law and, in accordance therewith, will prohibit M from wholly spending the grant principal in the year of the grant. You state that, because of this prohibition, your transfer of assets to M will not constitute a qualifying distribution under section 4942 of the Code. The Endowment Grant Agreement provides that three years after that agreement goes into effect, M may use both the principal and the income for the charitable purposes for which it is organized.

You will maintain expenditure responsibility over your grant to M in accordance with the Expenditure Responsibility Agreement executed by your trustees. Your agreement states that you are making the grant for capital endowment purposes and requires M to provide full and complete annual reports on how the funds are spent. The agreement also requires M to keep records for at least three years after the completion of the use of the grant funds or until such time as you are no longer required to exercise expenditure responsibility over the grant, whichever occurs sooner.

You state that you will not dissolve or terminate your private foundation status, that you have provided no notice of your intention to terminate to the Internal Revenue Service (Service) or received notification that your status as a private foundation has been terminated. Further, you state that you have not committed any willful repeated acts or willful and flagrant acts that give rise to liability under Chapter 42. Subsequent to the transfer, both you and M will continue to operate and maintain your status as tax-exempt private foundations.

Rulings Requested:

You have requested the following rulings:

1. Because you have not given, and do not intend to give, notice of termination pursuant to section 507(a)(1) of the Code, your transfer will not constitute a termination of your status as a private foundation, and accordingly, your transfer will not cause you to be subject to termination tax imposed under section 507(c) as a result of such transaction.
2. Your transfer of approximately 50 percent of your assets to M, made pursuant to a recapitalization or other adjustment or reorganization, will constitute a permissive transfer of assets from one private foundation to another private foundation as described in section 507(b)(2) of the Code.
3. Your transfer of approximately 50 percent of your assets to M will not adversely affect your exemption from federal income tax under section 501(c)(3) of the Code.
4. Your transfer of approximately 50 percent of your assets to M will not impose on you a tax on net investment income pursuant to section 4940 of the Code.
5. Your transfer of approximately 50 percent of your assets to M will not constitute a direct or indirect act of self-dealing under section 4941 of the Code with regard to you or any foundation managers, substantial contributors or other disqualified persons of you, and thus will not give rise to the tax on self-dealing under section 4941.
6. The transfer of approximately 50 percent of your assets to M will not constitute an investment by you, which jeopardizes the exempt purposes of you under section 4944 of the Code and thus, will not trigger the tax on jeopardy investments under section 4944.
7. The transfer of approximately 50 percent of your assets to M will constitute a "grant" as

described in section 4945(d)(4) of the Code and as such will not constitute a taxable expenditure under section 4945, provided that you exercise expenditure responsibility over the distributed assets in accordance with section 4945(h) with respect to your transfer to M.

8. Your transfer of approximately 50 percent of your assets to M will constitute a grant for endowment as contemplated in section 4945(d)(4) of the Code and section 53.4945-5(c)(2) of the Foundation and Similar Excise Tax Regulations ("foundation regulations"). As a result, you must require reports from M on your use of the principal and income (if any) from the grant funds for the taxable year in which such grant is made and for the immediately succeeding two taxable years. Only if it is reasonably apparent to you that, before the end of the second succeeding taxable year, neither the principal, nor the income from the grant funds, has been used for any purpose which would result in liability for tax under section 4945(d), may you then allow such reports to be discontinued. You may satisfy section 4945(h)(3) by (1) obtaining from the trustees of M, after the transfer of the assets, reports of the use by M of the principal of and the income (if any) from the assets transferred to it by you for the calendar year in which the transfer of assets occurs, and for the immediately succeeding two taxable years, (2) including in M's Form 990-PF returns for such years reports containing the information specified in section 53.4945-5(d)(2), (3) maintaining in your permanent records a copy of the Endowment Grant Agreement, the Expenditure Responsibility Agreement, each report received from M, and each report of your personnel or independent auditors concerning the transfer to M, and (4) taking all reasonable and appropriate actions to correct any diversion by M of the transferred assets and income therefrom from M's charitable purposes.
9. The reasonable and necessary legal, accounting, organizational and other professional and administrative expenses incurred by you in connection with this ruling request and in carrying out this transaction will constitute qualifying distributions under section 4942 of the Code and will not constitute taxable expenditures under section 4945.

Law:

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, educational and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 507(a) of the Code provides that, except as provided in section 507(b), a private foundation may terminate its private foundation status only under the specific rules set forth in section 507(a).

Section 507(b)(2) of the Code provides that in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization, the transferee foundation shall not be treated as a newly created organization.

Section 507(c) of the Code imposes on each organization which is referred to in subsection (a) a tax equal to the lower of the "aggregate tax benefit" resulting from the tax exempt status of the private foundation or the value of the net assets of such foundation.

Section 4940(a) of the Code imposes on each private foundation, which is exempt from taxation under section 501(a) for the taxable year, with respect to the carrying on of its activities, an excise tax of two percent of the net investment income of the foundation for the taxable year.

Section 4940(c)(1) of the Code defines the term "net investment income" as the amount by which the sum of the gross investment income and the capital gain net income exceeds certain deductions.

Section 4941(a) of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4942(a) of the Code imposes annual excise taxes on the "undistributed income" of a private foundation.

Section 4944(a) of the Code imposes a tax on any investment that jeopardizes an exempt organization's charitable purpose.

Section 4944(c) of the Code states that, for purposes of this section, the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B), and not significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which jeopardize the carrying out of exempt purposes.

Section 4945(d)(4) of the Code provides the term "taxable expenditure" includes a grant to a private foundation unless the grantor exercises expenditure responsibility in accordance with section 4945(h).

Section 4945(h) of the Code states that "expenditure responsibility" means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures: (1) to see that the grant is spent solely for the purpose for which made, (2) to obtain full and complete reports from the grantee on how the funds are spent, and (3) to make full and detailed reports with respect to the Internal Revenue Service.

Section 1.507-1(b)(6) of the Treasury Regulations (hereafter the "regulations") provides that if a private foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in section 507(b)(2) of the Code, such transferor foundation will not have terminated its foundation status under section 507(a)(1).

Section 1.507-3(c)(1) of the regulations provides that, as used in section 507(b)(2) of the Code, the term "other adjustment, organization or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

Section 1.507-3(c)(2) of the regulations defines the term "significant disposition of assets to one or more private foundations" as any disposition or series of dispositions where the cumulative total of dispositions is 25 percent or more of the fair market value of the net assets of the foundation at the beginning of the taxable year.

Section 1.507-4(b) of the regulations provides that private foundations which make transfers described in section 507(b)(1)(A) or section 507(b)(2) of the Code are not subject to the tax imposed under section 507(c) with respect to such transfers unless the provisions of section 507(a) become applicable.

Section 53.4942(a)-3(a)(2) of the Foundation and Similar Excise Tax Regulations (foundation regulations) defines the term "qualifying distribution", in relevant part, to mean any amount (including program related investments and reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in Code section 170(c)(1) or 170(c)(2)(B), other than any contribution to a private foundation which is not an operating foundation or to an organization controlled (directly or indirectly) by the contributing private foundation or one or more disqualified persons with respect to such foundation, except as provided in paragraph (c) of this section.

Section 53.4942(a)-3(c) of the foundation regulations states that, for purposes of this section, the term "qualifying distribution" includes (in the year in which paid) a contribution to an exempt organization described in section 501(c)(3) of the Code and described in paragraph (a)(2)(i)(a) or (b) of this section if (i) not later than the close of the first taxable year after the donee organization's taxable year in which such contribution is received, such donee organization makes a distribution equal to the full amount of such contribution and such distribution is a qualifying distribution (within the meaning of paragraph (a) of this section, without regard to this paragraph) which is treated under paragraph (d) of this section as a distribution out of corpus (or would be so treated if such section 501(c)(3) organization were a private foundation which is not an operating foundation).

Section 53.4945-5(c)(2) of the foundation regulations provides that, with regard to capital endowment grants made to private foundations, if a private foundation makes a grant to another private foundation for endowment or for other capital purposes, the grantor foundation must require reports from the grantee foundation on the uses of the principal and the income (if any) from the grant funds. The grantee must make such reports annually for the tax year in which the grant was made and for the immediately succeeding two tax years. Only if it is reasonably apparent to the grantor, before the end of such grantee's second succeeding tax year, that neither the principal nor the income from the grant funds has been used for any purpose which would result in liability for tax under section 4945(d) of the Code, may the grantor then allow the grantee's reports to be discontinued.

Section 53.4945-6(b)(2) of the foundation regulations provides that expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under section 4945(d)(5) of the Code unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such

expenses in such amounts was consistent with ordinary business care and prudence. The determination whether an expenditure is unreasonable shall depend upon the facts and circumstances of the particular case.

Section 53.4946-1(a)(8) of the foundation regulations states that, for purposes of section 4941 of the Code only, the term "disqualified person" shall not include any organization which is described in section 501(c)(3) (other than an organization described in section 509(a)(4)).

Analysis:

Ruling 1:

Pursuant to section 1.507-4(b) of the regulations, a private foundation that makes a transfer described in section 507(b)(2) of the Code is not subject to the tax imposed under section 507(c) with respect to such transfer unless the provisions of section 507(a) become applicable. As discussed in Ruling 2 below, your transfer will constitute a significant distribution of assets described in section 507(b)(2). You represented that you have not provided notice of your intention to terminate to the Service or received notification that your status as a private foundation has been terminated. Further, you stated that you have not committed any willful or flagrant acts or failures to act that give rise to liability under Chapter 42. Therefore, your proposed transfer of assets to M under section 507(b)(2) will not terminate your private foundation status under section 507(a) and does not result in a termination tax imposed by section 507(c).

Ruling 2:

Section 507(b)(2) of the Code describes a transfer from one private foundation to another private foundation according to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. Section 1.507-3(c)(1) of the regulations describes the terms "other adjustment, organization, or reorganization" as including any partial liquidation or any other significant distribution of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income. The term "significant disposition of assets to one or more private foundations" is defined by section 1.507-3(c)(2) as any disposition or series of dispositions where the aggregate value transferred is 25 percent or more of the fair market value of the net assets of the foundation at the beginning of the taxable year. Since you are transferring more than 25 percent of the fair market value of your net assets to M, a private foundation, for no consideration, your proposed transfer is a significant disposition of assets that qualifies as a transfer under section 507(b)(2).

Rulings 3 and 6:

Section 4944 of the Code imposes a tax on any investment that jeopardizes an exempt organization's charitable purpose. Because you will make the transfer to further charitable purposes and M is exempt under section 501(c)(3), the transfer will not adversely affect your exempt status, nor will it be treated as a jeopardizing investment within the meaning of section 4944. See section 4944(c).

## Ruling 4:

Section 4940(c) of the Code imposes an excise tax on investment income received by private foundations. Investment income includes capital gains from the sale or other disposition of property. The transfer of assets by you to M, which lacks consideration, does not constitute a "sale or other disposition of property" that would generate capital gains subject to excise tax under section 4940. Therefore, the transfer will not be treated as a taxable sale or disposition of property within the meaning of section 4940.

## Ruling 5:

Section 4941(a) of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation. Sections 4941 and 1.507-3(a) of the regulations determine whether the proposed transfer of assets to M will constitute an act of self-dealing between a private foundation and its disqualified persons, as defined in section 4946. Under section 53.4946-1(a)(8) of the foundation regulations, a "disqualified person" does not include organizations that are exempt under section 501(c)(3). Your transfer of assets to M is not an act of self-dealing because M is recognized by the Service as an organization exempt from tax under section 501(c)(3).

## Rulings 7 and 8:

Under section 4945(d) of the Code, any grant by a private foundation to an organization that is neither an exempt operating foundation nor described in 509(a)(1), (2), or (3) constitutes a "taxable expenditure" unless the private foundation exercises expenditure responsibility with respect to such grant. The transfer will not constitute a taxable expenditure under section 4945(d)(4) as long as you comply with the expenditure responsibility requirements of sections 4945(h) and 53.4945-5(c)(2) of the foundation regulations. Your expenditure agreement states that your section 507(b)(2) transfer of assets to M is a grant to M for capital endowment purposes and requires M to provide full and complete annual reports on how the funds are spent. It also requires M to keep records for at least three years after the completion of the use of the grant funds or until such time as you are no longer required to exercise expenditure responsibility over the grant, whichever occurs sooner. Since you have agreed to exercise expenditure responsibility, the transfer will not constitute a taxable expenditure.

## Ruling 9:

The term "qualifying distribution" includes reasonable and necessary administrative expenses paid to accomplish one or more purposes described in section 170(c)(1) or (2)(B) of the Code, other than any contribution to an organization controlled (directly or indirectly) by the contributing private foundation or one or more disqualified persons with respect to such foundation, except as provided in paragraph (c) of this section. See section 53.4942(a)-3(a)(2) of the foundation regulations.

Paragraph (c) of section 4942(a)-3(a)(2)(c) of the foundation regulations states that the term

"qualifying distribution" includes (in the year in which paid) a contribution to an exempt organization described in section 501(c)(3) of the Code and described in paragraph (a)(2)(i)(a) or (b) of this section if (i) not later than the close of the first taxable year after the donee organization's taxable year in which such contribution is received, such donee organization makes a distribution equal to the full amount of such contribution and such distribution is a qualifying distribution which is treated under paragraph (d) of this section as a distribution out of corpus (or would be so treated if such section 501(c)(3) organization were a private foundation which is not an operating foundation). You stated that your transfer to M is not a qualifying distribution because M will not meet the redistribution requirements. For the same reasons, the legal and accounting expenses related to your transfer to M will not constitute "qualifying distributions" under section 4942 unless M meets the redistribution requirements set forth in paragraph (c).

Any expenditures for unreasonable administrative expenses are ordinarily taxable expenditures under section 4945(d)(5) of the Code unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was consistent with ordinary business care and prudence. See section 53.4945-6(b)(2) of the foundation regulations. You state that you paid the reasonable and necessary legal, accounting, organizational and other expenses in connection with this ruling request and in carrying out the transaction to achieve the charitable purposes of making grants to M. As long as you and M can demonstrate that you paid the expenses in the good faith belief that they were reasonable and consistent with ordinary business care and prudence, the expenses will not constitute taxable expenditures.

#### Conclusion:

Based on the foregoing, we rule as follows:

1. Your transfer to M will not cause you to be subject to the termination tax imposed by section 507(c).
2. Your transfer to M will constitute a transfer of assets from one private foundation to another private foundation described in section 507(b)(2) of the Code.
3. Your transfer to M will not adversely affect your exemption from federal income tax under section 501(c)(3) of the Code.
4. Your transfer to M will not give rise to the imposition of tax on your net investment income pursuant to section 4940 of the Code.
5. Your transfer to M will not constitute a direct or indirect act of self-dealing under section 4941 of the Code with regard to you or any foundation managers, substantial contributors or other disqualified persons of you or M.
6. Your transfer to M does not constitute a jeopardizing investment within the meaning of section 4944 of the Code.
7. ; 8. Your transfer to M will constitute a "grant" as described in section 4945(d)(4) of the Code and, as such, will not constitute a taxable expenditure under section 4945, provided that you exercise expenditure responsibility over the distributed assets in accordance with sections 4945(h) and 53.4945-5(c)(2), including the information reporting requirements on Form 990-PF for the year of the transfer.
9. The reasonable and necessary legal, accounting, organizational and other professional

and administrative expenses incurred by you in connection with this ruling request and in carrying out this transaction will not constitute qualifying distributions under section 4942 of the Code and will not constitute taxable expenditures under section 4945.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records. If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Steven Grodnitzky  
Manager, Exempt Organizations  
Technical Group 1

Enclosure  
Notice 437